International support

Georgian authorities have mobilized US$ 3.0bn financing from IMF and other international partners (WB, EU, EBRD, EIB, ADB, etc.) to respond effectively to COVID-19 pandemic associated economic crisis. Georgia’s long-lasting ties with these institutions, prudent economic policymaking of recent years and country’s aspiration to democratic changes made this support from good friends possible. Out of this funding, US$ 1.5bn is earmarked for public sector and US$ 1.5bn for private sector. IMF’s financing is c. US$ 400mn, from which US$ 200mn will be made available immediately to the budget and US$ 100mn to NBG in 2H20 and another US$ 100mn in 2021. With this support, we estimate that stimulus in 2020 will be substantial at 11-15% of GDP, which will help to finance health and macroeconomic stabilization measures.

Government measures

Before news on donor financing, authorities announced GEL 2bn fiscal stimulus measures for affected business and households. Property and income tax payments were postponed for most sensitive industries (tourism and hospitality services) until November 2020. Subsidies for medium sized hotel debt repayment, additional GEL 300mn for public infrastructure projects and extra GEL 600mn VAT refunds for businesses, and subsidies for households’ utility costs for 3 months were also announced. In addition, the government introduced price subsidies for 9 food products (mostly imported) - rice, buckwheat, pasta, oil, flour, wheat, milk powder, sugar and beans - to limit GEL depreciation impact.

The government is currently working on a revised budget document, which will be available in May. The document will shed light on how donor funding will be allocated for various programs. At the moment, we have our assessment based on briefings by senior government officials, where they are aimed at supporting households (social assistance, utility cost financing, etc.), as well as enterprises (guarantee mechanisms, tax moratorium, etc.) We see the need for government financing at GEL 3.8bn GEL in 2020 (due to the reduced tax revenues and rising spending) and the budget deficit to increase to 9% of GDP.

In the medium and long term, we expect to see fundamental changes in the Georgian economic model that will allow to utilize the potential in agriculture and other sectors (textiles, building materials, pharmaceuticals, etc.) and realize advantage of the free trade agreement between the EU and Georgia. This change will lead to the creation of more decent jobs in our view, which is lacking as employment has been on a rise in low wage sectors - trade and hospitality - in recent years. We expect government to put more emphasis to attract FDI and support industries which have import substitution potential.

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Coronavirus
The first case of coronavirus in the country was confirmed on 26 February, linked to travelers from Iran. As of 22 April, 408 cases were confirmed, of which 97 recovered and 5 died. 5,160 people are currently quarantined (mostly at hotels which is funded by government and some are placed at home). Georgia has responded the virus outbreak promptly. Before international flights were banned entirely on 18 March, travel was initially banned from China and Iran. Full lockdown was introduced on 21 March for a month – to limit Easter gathering at church on 19 April. The recent peak in new daily cases was on 16 April, and there is some optimism that the peak might be over as only few gathered at church on Easter. Importantly, Georgia has one of the lowest active coronavirus cases globally at 10 per 100,000 persons. We think that containment of the virus in May-June will allow an economy to function relatively normally and could make us more optimistic about recovery dynamics.

GDP and current account deficit
IMF forecasts -4% GDP growth in 2020 in Georgia and we agree on this, but we hope for a better recovery at 5% in 2021 vs. IMF forecast of 3%. However we have a different view on the current account deficit - our projection 6% of GDP vs. 10.5% of IMF. This is because we expect a significant reduction in imports (savings in oil imports, demand collapse) which is expected to largely compensate tourism revenue loss in 2020. Our forecast is also backed by expectation that large part of the fiscal stimulus will be current spending in nature (supporting vulnerable population, tax moratorium/subsidies for companies, etc.), but imports will be limited do to unwillingness to spend on luxury good items (cars, phones, home appliances and other electronic commodities are almost third of imports). On top of this, now we are more optimistic on remittances, which declined less than our projection for March (remittances were down 9% y/y, and now we expect 10% decline for the whole 2020, vs our initial forecast of 15-20%). We published our initial assessment on 25 March.

Currency
GEL was too volatile varying from 2.85 to 3.48 against US$, during 11-27 March. In response, NBG sold US$ 100mn at 3 interventions to support the currency in March. The market reacted positively and the lari stabilized at c. GEL3.15 vs. dollar during April. The regulator has communicated that while it does not target any particular point of GEL vs. dollar, it will continue to support the currency this year to limit panic sell-off. So we expect FX sale in the amount of US$ 400mn through 2020. External support will allow NBG to do so without jeopardizing reserves (as budget support loans from IFIs will replenish reserves, while NBG will provide the equivalent lari to the government for spending). This means that despite interventions international reserves can increase at end 2020 (at US$ 3.4bn in March). It is important to note that the leadership of NBG is now very open, frequently appears on TV and explains its policies, which is very positive for credibility and transparency. For providing additional FX liquidity to the market the regulator can also cut reserve requirement by 5-10ppt to 20-15% which could provide c. $300-600mn of additional FX liquidity to the banking system. Interventions will allow NBG not to hike the policy rate from the current 9% this year, but we also do not exclude the 1ppt policy rate hike if market mood changes and GEL weakens to 3.5 vs. dollar.

In NBG’s communication of 18 March 2020, the regulator commented that the interest rate may move in both directions depending on the exchange rate/demand movements (GEL depreciation pass-through may dictate rate increase, while low demand will require
rate cut). Annual inflation has been retreating gradually since the year started with 6.1% inflation in March 2020. We expect inflationary pressures to be eased (we forecast 4.7% average inflation in 2020) due to low demand and subsidized prices from government for 9 key imported food products in 2020.

**GEL liquidity**

With economy under the lockdown and conversion into dollar deposits (dollarization up c.5ppts in March) there is shortage of GEL liquidity. The result is hike in GEL deposit rates by around 3ppts to 12% recently on current accounts, based on market participants. We believe that this is very detrimental to the functioning of the economy during the crisis. NBG needs to provide sufficient GEL liquidity to the economy for GEL interest rates to remain low and not to cause additional demand collapse. We understand that concern is the pressure on the currency, and for this NBG needs to sell FX and decrease FX reserve requirement to curb GEL’s excessive volatility, in our view.

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**Figure 1: Currency vs. US$, (index, 1 Jan 2020 = 100)**

Source: Bloomberg

**Figure 2: Inflation in Georgia**

Source: Gostat

**Figure 3: IMF’s GDP forecast for 2020**

Source: IMF, April 2020

**Figure 4: Georgia’s international reserves**

Source: NBG
Figure 5: NBG's loans to banks

Source: NBG

Figure 6: Government deposits

Government deposit at the NBG, GEL mn
Government deposit at commercial banks, GEL mn

Figure 7: COVID-19 cases per 100,000 persons

Source: Johns Hopkins, Worldometers
Note: As of 10:00 AM, April 22, 2020

Figure 8: COVID-19 statistics in Georgia, persons

Source: NCDC
Note: As of 10:00 AM, April 22, 2020
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